ECO 450G Notes - Spring 2003 Semester – February 13, 2003

Chapter 5 – Age and Health

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I. Age

Over 3 million elderly were poor in 1998, moreover, this number excludes the institutionalized and perhaps some elderly living in "disguised poverty" with other, younger family members.

Declining Poverty Rate

The elderly have moved from being relatively disadvantaged to relatively advantaged. Poverty rates in the 1960s were higher than for other age groups, by the 1990s, poverty rates were among the lowest.

Why?

Social Security is fairly generous, and indexed for inflation

Medicare and Medicaid are both valuable (although they do not count as income)

Life expectancy has increased dramatically. Life expectancy, conditional on reaching age 65, has increased from 11 years to 17 years in the past century.

> Note, however, that the greatest gains in life expectancy have come from reductions in *infant mortality* at the beginning of life rather than from technologies at the end of life. Life expectancy at birth in 1900 was 49 years, now it is 76 years. Infant mortality, which is the number of infant deaths before age 1, divided by the number of infants born, has declined dramatically.
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> See http://aspe.hhs.gov/2000gb/appeng.txt for infant mortality from 1940 to the present. In 1940, 47 out of every 1000 live births resulted in death before 12 months of age; in 1998, only 7.2 out of every 1000. Most of those babies who would have died now add a lot of additional years to mortality.
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> Why should life expectancy matter for poverty rates? Increased life expectancy results in a number of things; first the horizon is increased where the elderly will need to finance their retirement. Holding income and savings constant, increasing the horizon will increase the likelihood of poverty. On the other hand, to the extent that individuals increase their retirement savings, poverty should be lower, especially for the younger elderly.

Diversity Among the Aged

Poverty rates rise sharply with age – among those 85 and older, poverty rates are 50% higher than among those aged 65-74.

Why? First, family structure often changes as families age because of widowhood, and many husbands (who often die first) do a poor job of planning finances after their death. Second, elderly couples draw down on their savings during retirement – so younger couples have higher levels of interest, dividends and capital gains.

There is also one important reason to think that poverty rate gaps between the youngest old and the oldest old are actually understated. Between 65 and 85, many individuals die – presumably those who are the least healthy. There are clearly documented correlations between income and health (where the poor are the least healthy), so if those who died before age 85 had instead reached that age, they would be poor than average. Hence poverty rates would be even higher.

Sources of Economic Support

There are several potential sources of income for the elderly:

Earnings: Are not very important; labor force participation rates are less than 20%. There has been a dramatic trend downward over the century in labor force participation of the elderly, even though jobs are less physically demanding and the elderly are healthier. Declining labor force participation is likely related to a) the growth in wealth, b) the growth in the amount of income that Social Security replaces, c) the growth in disability income, d) the increased opportunities for leisure, e) reduced demand for skills of the elderly, and f) forced retirement.

Schiller cites a 25-year old study that reports that many older persons were "forced" out of their jobs. It is not clear whether the numbers would be similar today, and it is not clear how long those people who were forced out of their jobs would have remained at their job anyhow. The earnings loss is likely not that large.

Assets: Wealth levels are often inadequate for retirement, in the absence of social security. Schiller reports that the median household net worth was around $140,000, most of which is held in the form of home equity. Financial assets - stocks, bonds, bank accounts, 401(k)'s, etc. – are on average less than 20% of wealth holdings. It is important to note that although houses are certainly less liquid than other assets such as stocks or mutual funds, there are ways to get cash out of your home besides selling it or refinancing it. The elderly can get a "reverse mortgage" – which is paid off when the person dies from the proceeds of the home. See http://www.aarp.org/revmort/ for details.

These wealth levels also do not include the value of *defined benefit (DB)* plans – pensions that are based on years of service, age at retirement, and highest wages. They do include *defined contribution (DC)* plans like 401(k)s. The wealth levels also do not account for social security wealth – the fact that social security is an annuity that pays you until death. The levels also do not include anticipated bequests that may be received from even older parents.

Income sources: The nonpoor have more income from assets and pensions; they also have substantially more earnings (and unemployment insurance), which suggests that

they are also probably younger. The poor are more likely to have cash welfare, from *Supplemental Security Income (SSI)* as well as food stamps and housing.

New Poverty or Continuing Poverty

One key question with the poor elderly is why didn't they adequately plan for their retirement?

Squandered Income: Schiller asserts "There is no evidence that the aged poor enjoyed especially lascivious or spendthrift lives." Hence, Schiller is arguing that *restricted opportunity* is largely the result for poor elderly – e.g., "misery of their old age is simply the conclusion of a life of misery. ... Many, probably most, of the aged poor were always in or on the margin of poverty."

On the other hand, the fact that

> "people's essential optimism is revealed in consumer surveys such as one disclosing that families who have not had as much as $500 in the bank during the last five years confidently anticipating a comfortable retirement."

is more of a statement about *flawed character* – that individuals are not always willing to take the difficult, necessary steps of foregoing consumption today for a better retirement.

Finally, there is evidence in the economics literature that income- and asset-tested programs deter people from saving for their retirement, because tax rates on wealth can be 100%. Thus, *big brother* may play a role in low savings and poverty.

Pensions: Schiller assets that many "pension plans are often great disillusionments ... many workers ... find that they have no pension rights." The importance of this was important in the past (especially before 1974), but is not nearly as important now. The vesting period for pensions is now between *five and seven years* – see http://www.bls.gov/opub/mlr/1988/08/art4full.pdf for discussion.
It is true that most defined benefit pensions are not indexed for inflation, so their real value declines over time.

Social Security: Are far-reaching, and the most important single income source for the elderly. They are adjusted for inflation, and vary based on contributions into the system during one's working life. Although benefits are higher for those with higher earnings, social security implicitly redistributes to low-earners because the benefits formula is progressive.

Families: Less than one-third of the elderly live with relatives; not much support comes from offspring. Schiller asserts that many of these elderly are in "disguised poverty" because they do not command enough economic resources to really have a choice about whether to live on their own. The same argument could be made for many other family members, however – some married couples remain married more out of economic necessity than anything else.

Welfare: SSI is a fairly important source of income support for the poor, and has more generous benefits than AFDC / TANF.

Rising Health Costs
Many elderly have declining health – only 1 out of 6 self-report themselves in "excellent" health, and the fraction who experience limitations with ADLs (Activities of Daily Living) rises dramatically with age. Health care costs are also very expensive – around $6000 per year for the elderly. Medicare, which covers virtually all elderly, pays for many health care costs but not all. It generally does not cover prescription drugs or nursing homes. Medicaid covers some of these gaps for the poor elderly.

Tax Burdens
The elderly also pay property taxes that are related to the value of the home, which is usually rising. Many states have additional exemptions for the elderly, to insulate them to some extent from rising property taxes. Some states, like California, have limitations on the assessed value of the house.

Schiller presents no evidence on the importance of property taxes for the well-being of the elderly.

Making Do
Many elderly do, in fact, struggle.

Assessing Causation
Some of the poor elderly were always poor, others were not. There are potentially merits to many explanations for why people are poor.

II. Health

Good health contributes to economic security in a number of ways. Health care costs are lower, work productivity and wages are higher, and individuals have more time for work. Figure 5.5 shows that those who are disabled are much more likely to be poor.

Schiller breaks out the sample into those with a "severe" disability and "any" disability, but it is not clear where in the CPS questionnaire he is making that kind of classification.

Moreover, the disability question in the CPS asks: "Does (the respondent) have a health problem or disability which limits the kind or amount or work?" and "Did (the respondent) retire or leave a job for health reasons." Both of these do not simply ask about disabilities, but how those disabilities affect work. Hence, it is not surprising that there is a strong relationship.

Causality
Obviously disabilities can make it difficult for a person to work, and hence, be poor. On the other hand, low income can result in a variety of health problems and disabilities. Poor families have higher disease and mortality rates at any given age, and more absenteeism.

> Schiller asserts on page 106, "A family need not be far above the poverty line to have an adequate margin against the against the burdens of ill health. ... Average medical expenses ... are around $3000 ... hence, for a typical family ... $20000 would easily prevent slippage into poverty as a result of illness."
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> This statement is about as far from the truth as possible. Medical expenses are *highly skewed*, meaning that many individuals have zero (or near-zero) expenses in a year, and others have tremendous expenses. The top 10 percent consume about 70 percent of services, while the bottom 70 percent only consume 10 percent of expenses. See Table 4 (page 125) of http://gatton.uky.edu/Faculty/yelowitz/450G/cutler.pdf . Thus, in the event of an adverse health outcome, it would certainly take more than the $3000 average to prevent slippage into poverty.

Health Insurance

Virtually all elderly have health insurance through Medicare, and many of the poor also have Medicaid. Among the entire population, about 15% are uninsured for the entire year. Many fewer of the poor have private health insurance, but many do have Medicaid. Access to health care under Medicaid is certainly better than under no insurance, but is usually worse than under a private plan; many doctors refuse Medicaid patients because the government reimbursement is too low.

Emergency rooms are another option, but they too can turn people away and will try to collect on the bill.

III. Summary

Age and illness are both associated with poor economic status, but it is not clear which way the direction goes or why people got to the poor situation that they are in.